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LOS ANGELES BAR BULLETIN



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LOS ANGELES BAR BULLETIN

Official Monthly Publication of Los Angeles Bar Association. Entered as second class matter October 15, 1943, at the Postoffice at Los Angeles, California, under Act of March 3, 1879. Subscription Price \$1.00 a Year; 10c a Copy.

VOL. 22

JANUARY, 1947

No. 5

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A WORD FROM THE PRESIDENT

THE President of American Bar Association, Mr. Carl B. Rix, of Milwaukee, will be the guest and speaker at the January meeting of our Association. The visit of Mr. Rix offers an occasion for comment on the relations between the Associations.

About one thousand Los Angeles lawyers are members of American Bar Association and make up about one-thirty-seventh of the total membership. A substantial percentage of the lawyers of the other cities of the county and Southern California also are members of the Association. Our Association is furnishing the present representative of the Ninth Circuit on the Board of Governors of American Bar Association in the person of Loyd Wright who was elected to the position at the Convention in last December and will hold office for a 3-year term.

While membership in American Bar Association is on an individual basis, the importance of coordinating the policies and work of local, state and national associations is recognized by the existence of the House of Delegates of American Bar Association. Local associations with membership of over eight hundred are entitled to representatives in the House of Delegates.

Our Association has been represented since the creation of the House, Paul Fussell being our present delegate. The House of Delegates meets twice a year, once at the time of the Convention and once in the spring of the year.

In the fields of legal ethics, unauthorized practice of law, legal aid, low cost legal service, American Bar Association has coordinated the policies throughout the country so that local associations look to it for general policy guidance in those fields. In the fields of legal education, judicial selection, court administration, Bill of Rights, public relations, the local associations look to it for ideas, for experience, for assistance and for coordination. In the general fields of improving local procedural law and local administrative law, and in the fields of bar association administration, lawyer placement, law lecture courses, social activities and personal services and benefits (such as our Health and Accident Insurance Plan), the local associations profit from ideas and experience in other states as suggested and coordinated through American Bar Association action. In the fields of national government, national activities and international affairs, the local associations look generally to American Bar Association for action and contribute their parts through proposals for American Bar Association action and through local support of American Bar Association measures.

Every lawyer who has considered the subject concedes the need for group organization and group action by lawyers. Organization for action on a national basis is needed in addition to organization for action on the local basis. A young woman member of our local Women's Junior Committee said to me recently "If I am going to be a lawyer, I want to be in on the things that lawyers do."

Alex W. Davis

LOS ANGELES BAR ASSOCIATION 1947 Law Lecture Series

The Los Angeles Bar Association, in cooperation with The State Bar Committee on Continuing Education, has announced its Ninth Annual Series of Law Lectures to be held in the assembly hall of The State Building in Los Angeles.

The courses, lecturers and dates are as follows:

ESTATE PLANNING

MAYNARD J. TOLL, OF

O'MELVENY & MYERS

Jan. 29 & Feb. 5, 1947

CORPORATION LAW AND PROCEDURE

ROSS C. FISHER, OF

FARRAND & FARRAND

Feb. 12 & Feb. 19, 1947

STATE AND FEDERAL ADMINISTRATIVE

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Feb. 26, 1947

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Mar. 5 & Mar. 12, 1947

CIVIL PRACTICE IN FEDERAL

COURTS

HON. WILLIAM MATHES,

Judge, United States

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Mar. 19, 1947

A cordial invitation to attend this course of lectures is extended by the Los Angeles Bar Association to all lawyers.

ROBERT BALLANTYNE,

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PHILIP H. RICHARDS, *Chairman.*

COMPREHENSIVE ZONING PLAN FOR LOS ANGELES

By Clyde P. Harrell, Jr., of the Los Angeles Bar

ON JUNE 1, 1946, a new comprehensive zoning plan of the City of Los Angeles became a reality. This plan was created by Ordinance 90500 which amended Articles 2, 3, 4, 5 and 6 of Chapter I of the Los Angeles Municipal Code and certain other pertinent provisions of the Code relating to zoning.

HISTORY OF ZONING

Ordinance 90500 marks the first time that a single zoning plan covering the entire City of Los Angeles has been attempted. In the year 1920 the City of Los Angeles enacted Ordinance No. 33761 which was commonly known as the "Residential District Ordinance." By the provisions of this ordinance the City Council declared any property might continue to be used for the purpose to which it was devoted at the time of the enactment of the ordinance but that all property not in use on the effective date of the ordinance was residential or limited business property. Thus, if a person desired to use his property for a purpose other than residential or limited business, he was required to obtain an exception from the provisions of this ordinance. The procedure prescribed was the filing of an application with the Board of City Planning Commissioners, who in turn made recommendations to the City Council concerning the application. The City Council was required to pass an ordinance excepting the particular property from the Residential District Ordinance in order that one might use his property for any purposes other than residential.

In the meantime the Department of City Planning made certain surveys for the purpose of classifying property. In the year 1921 Ordinance 42666 (New Series) was adopted. This ordinance, which covered only a relatively small portion of the City of Los Angeles, adopted several zoning maps covering certain more or less contiguous sections of the City of Los Angeles. The ordinance created five districts or zones ranging from Residential A to Heavy Industrial E. This ordinance provided that the owner or lessee of land might make application to the Board of City Planning Commissioners for a change of zone or for a variance from the provisions of the ordinance, whenever public convenience, necessity or general welfare required, or where some burden was imposed upon the particular property not imposed generally on property similarly situated. The Planning Commission, after holding public hearings on such application, was required to make its findings and recommendations thereon to the City Council. The City Council would then enact an ordinance granting the relief requested, if it so desired. In 1930, Ordinance 66750 was enacted breaking the five zones created by Ordinance 42666 (New Series) into nine zones. They

were R1, R2, R3, R4, C2, C3, M1, M2 and M3, and later a tenth zone CI was created.

Zone R1 permitted single family residences only;

Zone R2 permitted duplexes and doubles;

Zone R3 permitted multiple family units;

Zone R4 permitted height limit apartments, clubs and certain commercial enterprises, etc. ;

C zones provided for commercial uses; and

M zones provided for manufacturing uses.

From time to time zoning maps adopted by Ordinance 42666 (New Series) and Ordinance 66750 were amended and new property not theretofore included under zone classifications was incorporated in and made subject to the provisions of the said ordinances.

At one time and until the enactment of Ordinance 90500 we actually had in effect in the City of Los Angeles three separate zoning ordinances: the Residential District Ordinance, which was rewritten and incorporated in the provisions of Ordinance 74140 in 1934, Ordinance 42666 (New Series) and Ordinance 66750, all of which were later incorporated in the Los Angeles Municipal Code. Under these ordinances the undesirable practice of spot-zoning grew up. A glance at the zoning history of Los Angeles will readily indicate how the use of spot-zoning completely changed the character of residential neighborhoods. A service station was authorized here, a drug store there, and when any person was successful in getting an ordinance adopted granting him a so-called variance or exception to the provisions of the zone in a particular neighborhood, it wasn't long until others obtained like exceptions or variances.

In order to eliminate the practice of spot-zoning which has become so prevalent under previous regulations, in 1941 an amendment to the Charter of the City of Los Angeles was adopted creating the Office of Zoning Administrator and a Board of Zoning Appeals. In general the Zoning Administrator, a civil service employee, was given the power under certain limitations to grant variances from the provisions of zoning regulations in accordance with the provisions of ordinances later enacted. The right of appeal from decisions of the Zoning Administrator to the Board of Zoning Appeals was authorized.

The power of the Administrator to grant or deny a variance is fixed by the provisions of Sections 94 to 99½, inclusive, of the Los Angeles City Charter and ordinances adopted pursuant to said charter provisions, which at the present writing, is Ordinance 90500. Under Ordinance 90500 the City has adopted the first comprehensive zoning plan. The ten districts as created by Ordinance 66750 were again broken down and fifteen separate zones, defining the uses to which property may be put, were created. All of the real property located in the City of Los Angeles is now covered by Ordinance 90500.

This article will not deal with the uses authorized in the fifteen zones or districts. An article on that subject may appear later so this will be confined to the procedure which must be followed if variances from the zoning regulations are desired or changes of zone are indicated.

It is admitted by the Planning Department that the attempt at zoning the City of Los Angeles under the comprehensive plan now in effect was a tremendous task, and that many adjustments in zones and zoning boundaries must be made before it can be said that all of the provisions of the new ordinance are equitable. It is also admitted that the size of the task is such that in all probability a great many individual cases of discrimination against individual parcels of property probably exist. It is the desire of those who are responsible for this plan to make such adjustments as will be necessary when particular situations are called to their attention.

It should be noted that all of the provisions of Ordinance 90500 are incorporated into Article 2 of Chapter 1 of the Los Angeles Municipal Code. Reference to previous ordinances above referred to are no longer necessary for the purpose of determining what procedure will be followed.

Relief from the provisions of the ordinance may be obtained by the following methods:

1. By filing an application with the Zoning Administrator for a variance from the strict provisions of the ordinance. (Section 12.26 of the Los Angeles Municipal Code.)
2. By filing an application with the Zoning Administrator requesting a Conditional Permit. (Section 12.26 of the Los Angeles Municipal Code.)

3. By filing an application with the Board of City Planning Commissioners for a change of zone. (Section 12.23 of the Los Angeles Municipal Code.)

4. By filing an application with the Board of City Planning Commissioners for a Conditional Use Permit. (Section 12.24 of the Los Angeles Municipal Code.)

5. By the City Council on its own motion adopting an ordinance changing the zone. (Section 12.32 of the Los Angeles Municipal Code.)

VARIANCES AND CHANGES OF ZONE DISTINGUISHED

Before discussing the procedure to be followed if it is desired to obtain a variance from the provisions of the ordinance, a change of zone, or a conditional permit, it is well to define what is a variance, change of zone or conditional permit.

ZONE

The term "zone" is used by planners to describe an area or district which includes certain real property wherein particular uses of land are permitted and other uses of land are prohibited. Zones are created by legislative action and cannot be changed, altered or amended without legislative action.

VARIANCE

"Variance" is a term used to describe what is actually a permit to use a parcel of land for some purpose not authorized by the particular law which created or established the zone, when the strict application of the law results in some unnecessary hardship or conditions which are inconsistent with the general purpose and intent of the zoning law, or some burden is imposed upon a particular parcel of property not borne by other property in the same zone. A variance is a practical method whereby relief can be granted from the strict application of the law, within certain limitations prescribed by the law without amending the basic law establishing the zone. In the City of Los Angeles the jurisdiction for granting variances is vested in the Zoning Administrator.

CONDITIONAL PERMITS

A "conditional permit" as the term is used in the Los Angeles ordinance is the means by which authority is granted to the Zoning Administrator in some cases, to the Board of City Planning Commissioners in other cases, to authorize particular uses

of land for particular purposes as set forth in the provisions of Sections 12.24 and 12.25 of the Los Angeles Municipal Code, notwithstanding the fact that the particular use is prohibited by the basic zoning regulations.

For example: Under the authority granted to the Board of City Planning Commissioners for the granting of a Conditional Permit, a cemetery, airport, educational institution, public library or museum may be authorized in any zone, if the Commission first finds that the uses so authorized are deemed a part of the so-called master plan or conform to its objectives (Section 12.24, Los Angeles Municipal Code). Under Section 12.25 of the Los Angeles Municipal Code the Zoning Administrator is permitted to authorize the establishment of dog kennels and riding stables in certain zones, mortuaries and funeral parlors in others, and trailer camps and public camps in certain zones, or he may authorize the establishment of crematories, mausoleums, hospitals, sanatoriums, motion picture studios, nurseries, greenhouses, in any zone if he finds that the uses "are in harmony with the general purposes and intent of the comprehensive zoning plan; and are not detrimental to the immediate neighborhood."

ILLUSTRATION OF PROCEDURE ON APPLICATION FOR VARIANCE

Assume that a parcel of ground is located in an R2 zone (a zone in which two family residential buildings are permitted), and by reason of the particular shape of the lot, or the general character of the land, or the location of the zoning boundaries, it is impracticable to construct a two family building on the particular parcel of ground within the limitations of the R2 zone and still conform to the zoning regulation. In such a case the land could be utilized if authority could be obtained authorizing the construction of a portion of a two family building on land that extended into an adjacent R1 zone, which permits only single family residences.

Under such a situation the Zoning Administrator has jurisdiction under the provisions of Section 12.26 of the Los Angeles Municipal Code, to grant relief authorizing the use of land located in the R1 zone in connection with the property located in the adjacent R2 zone. Such relief is called a "variance."

In order to obtain relief by the variance process an application is filed with the Department of City Planning on forms

provided by the department for that purpose, and a map called a "Use Map," showing the use to which property located within 300 feet of the exterior boundaries of the property involved in the application is devoted, together with a list of the owners of such property must be attached (Sections 12.21 and Sub. 5, L. A. Municipal Code).

After the application is filed an investigation is made by the Zoning Administrator's Department and a report thereon is made; the matter is set for hearing, and at a time and place designated (usually three to four months under existing conditions) after filing of the application. A five day notice to the owners of property located within 300 feet of the exterior boundaries of the property involved in the application must be given, after which such hearing will be held (Sec. 12.26, Sub. 4, L. A. Municipal Code).

The Zoning Administrator must make a determination and shall transmit a copy of his decision to the Director of Planning and to the City Planning Commission (Sec. 12.26, Sub. 5, L. A. Municipal Code). The limitations imposed upon the Administrator to grant variances under any set of facts requires that he must make findings of fact showing:

(a) Unnecessary hardships resulting from the regulations, which are applicable to the particular property and which do not apply to the property of the same class or uses in the district.

(b) That such variance is necessary for the preservation and enjoyment of the substantial rights of the applicant.

(c) The granting of such variance will not be detrimental to the public welfare or injurious to the property in the district or zone in which the property is located.

(d) The granting of such a variance will not adversely affect the master plan (Section 12.26, Sub. 2, L. A. Municipal Code).

APPEAL FROM DECISION

A decision of the Zoning Administrator is final on all matters under his jurisdiction, unless an appeal is taken within ten days after the Administrator's written decision is made. Appeal is taken to the Board of Appeals and must be filed with the Zoning Administrator within said ten day period allowed for appeal (Section 12.26, Sub. 6, Los Angeles Municipal Code). Five days after receipt of notice of appeal the Zoning Administrator

is required to transmit a complete copy of the record to the Board. The Board of Zoning Appeals then sets the case for hearing at such time and place as may be determined after giving a five day postcard notice to owners of property located within 300 feet of the exterior boundaries of the property involved in the application (Section 12.27, L. A. Municipal Code). The decision of the Board of Zoning Appeals is final, subject of course to judicial remedy.

A succeeding article will discuss practical questions having to do with presentation of cases before the Zoning Administrator, the Board of Zoning Appeals and the City Planning Commission.

ECONOMICS INVESTMENTS, AND THE LAWYER

By Julian D. Weiss*

THE old saying, "The Supreme Court watches the election returns," is just another way of stating that the law is affected and conditioned by economic, political, social and psychological forces. The legal profession is recognizing that law cannot be practiced "in a vacuum," and that the problems which confront the practicing attorney are often of a combined economic, financial, and legal character. Therefore, it is vitally important for lawyers to be conversant with broad economic trends and specific phases of these related fields. After all, attorneys frequently are consulted by their clients on matters of general business policy. Related considerations are involved in specific problems of corporation finance, as well as in income and estate tax matters.

Taking this thesis as a point of departure, the following discussion is designed to cover a few of the "high spots" of some topics of practical interest to the attorney. The various subjects are considered primarily from investment and trust administrative (rather than purely legal) viewpoints. For purposes of perspective, and because it bears upon the specific subjects discussed, brief consideration is given to the contemporary economic scene.

*Member Illinois Bar. Registered Investment Counselor with S.E.C. and State of California. President, First Investment Corporation, Los Angeles.

I. GENERAL ECONOMIC FACTORS

One readily must admit the presence of certain imponderables. However, those concerned with corporate and business problems, as well as the personal affairs of individuals of means, must endeavor to appraise and evaluate the changing economic scene. It is perplexing to pick up the daily paper and find, side by side, the pronouncements of recognized economists—some of whom fear inflation, others deflation; to hear warnings about the dangers from rising farm prices and simultaneously be warned of the need to support farm prices as soon as a first decline appears; to read that wages must be raised further to maintain consumer purchasing power, and, conversely, that wages are the prime element of costs (and thus of price) and that further increases are economically unsound as they will price goods out of the market.

Naturally, an article of this type cannot attempt to take apart the jigsaw puzzle of our economy, and reconstruct it piece by piece. All that can be done is to briefly sketch some of the general aspects. Basically, the problem of maintaining business activity and employment at favorable levels involves a high level of supply (production) and demand (consumption). Since price is the meeting ground of these two elements, improved technology, greater worker productivity, and maximum volume of production are important, as they tend to reduce unit costs.

Demand for heavy producers' goods by industry fluctuates widely, being of a deferrable character and thus such expenditures are dependent largely upon business psychology and estimates of the outlook for future profits. Consumer demand is influenced by ability to buy as measured by real wages, and to a lesser degree by accumulated savings; also by willingness to buy, taking the price level into consideration. Department of Commerce surveys show that over a long period of years there has been a high correlation between disposable income of individuals and expenditures for various types of goods. Based on such studies, it is anticipated that expenditures for soft goods and luxury items will decline in 1947, while those for consumers semi-durables will increase.

Inventories are important. When they are low, production can equal demand plus inventory accumulation. When they are high in relation to demand, production and business activity must

be curtailed. At present inventories are at high levels historically, but the situation does not appear immediately dangerous as much of the increase has been caused by rising prices and thus physical inventories are up to a lesser degree. Also, inventories are not excessive in relation to demand, the stock-sales ratio being lower than in pre-war years. Also the increase reflects bottlenecks in production, increased labor costs and seasonal accumulation.

The level and trend of commodity prices, as well as the relationships between various types of commodities, affect business policies, costs, and real purchasing power. Prices generally have increased less than during, and immediately after, World War I. Some raw materials and food prices have increased more than prices of finished goods. Food prices likely will decline moderately in 1947, while finished goods prices probably will be firm in reflection of high labor costs.

The credit picture generally is favorable. Interest rates continue low. There may be some moderate contraction in reflection of further public debt retirement, but generally supply of credit remains more than adequate.

The above factors illustrate that the economic scene is not a snap-shot but rather a moving picture. It is always changing. The following conclusions, therefore, while predicated on careful study are subject to revision as warranted by continuous analysis. Present evidence indicates that the economic fundamentals essential to a period of prosperity are present. There is *ability* to produce at reasonable prices to meet the highest conceivable demand. There is abundant credit; there is no big superstructure of private debt to be liquidated; there is a large current and accumulated need (both domestic and foreign) for all types of goods; there is still the ability to buy. The big problems are those of human relationships. Will labor recognize that only higher productivity can increase real wages? Does it know that in a capitalistic system, risk-taking is an essential function, and that capital will assume risks only if there is opportunity for profits? Does labor know that if all the peak corporate profits earned in a war year were taken away and given to labor, it would mean not more than 8% wage increase? Will management recognize the need of progressivism in dealing with em-

ployees, and that prices must be held down to stimulate effective purchasing power?

It appears likely that 1947 will be a year of readjustment. It should not be a depression year. The nation's economic health, as measured by the usual quantitative standards, should be far above that of any pre-war year and better conditions appear a reasonable expectation for 1948 and 1949 unless there is a recurrence of large scale labor troubles.

II. ESTATE PLANNING

From the attorney's point of view, estate planning rests on the premise that action advantageous to the client benefits his legal counsel. A chat with the principal stockholders or partners of a business relative to their personal affairs can afford you, as attorney, an opportunity to render an important service. It shows the client you are anticipating his personal problems and are conversant with present tax developments and general economic complexities which make such an estate analysis vital to individuals of means. Aside from immediate fees to be derived from planning and drafting trust agreements and wills, where you are in touch with the private affairs of the principal and acquainted with the family, their desires and needs, the probability is greater that you will be retained in the settlement of the client's estate. Also, in some cases, action to be taken involves public financing or other steps relative to major assets of the client. This also means additional legal business.

Proper estate planning must be a tailor-made job, geared to the needs and objectives of the individual. It is affected by the size of the estate and the individual's family situation. It is exclusively the job of the attorney to decide what legal vehicles best can effectuate his client's objectives. The next problem, which is that of best expediting those objectives in actual practice, very often is an administrative problem which best can be solved by the combined efforts of legal and financial counsel. In some cases the best medium is to establish inter vivos trusts for the benefit of certain members of the family while in others it is a well drawn will creating a testamentary trust. Either of these alternatives involves a host of problems, including such financial matters as obtaining proper diversification of assets, timing of possible public sale of a portion of the client's busi-

ness, and so forth. Some of the benefits to the client are summarized below:

1. *Financial advantages with respect to income and estate taxes.*—For example, a living trust established for the benefit of one's children (so drawn, of course, as to indicate clearly that it is not a support and maintenance trust) can effect substantial income tax savings for an individual in high brackets. Or, if an individual establishes a testamentary trust and gives the wife only a life interest, as contrasted with an outright bequest of his property, a second set of succession taxes is avoided upon her death, thus maximizing the net estate accruing to the settlor's children.

In terms of Federal estate taxes alone, disregarding savings in state inheritance taxes, the picture would appear as follows:

Size of Net Estate	Tax on Out- right Transfer	Tax on Testa- mentary Trust	Approximate Saving
\$ 200,000	\$ 55,590	\$ 32,700	\$ 22,890
500,000	212,520	126,500	86,020
1,000,000	496,195	302,300	193,895

That this question of taxes is of long term rather than temporary importance is best seen by noting the tremendous government debt and the current and projected Federal budgets. These concretely illustrate that the present era of high taxes will be with us for a long time.

2. *Greater safety resulting from diversification.*—You can be certain that people of means are giving this subject serious consideration. Thus "The Exchange" (the official publication of the New York Stock Exchange) states in the June, 1946, issue: ". . . one may be led to inquire into the train of economic events which has forced partial liquidation of many former large holdings. Inheritance levies, income tax rates which hinder the accumulation of capital and considerations of diversity are among the well-known factors which in recent years have produced a stream of 'secondary' and 'special' offerings."

Numerous small businesses have grown to large stature during the war years. Many individuals have "all their eggs in one basket." There are obvious advantages in diversifying and protecting one's asset position by selling a portion of closed corporation holdings.

3. *Liquidity and Valuation.*—Where interests are concentrated in one or two closely held enterprises, the owners contemplate with concern what may happen to their estates after they pass out of the picture. Aside from the lack of liquidity, there is always the possibility that the Treasury Department may assess a high finding of value on these assets to the detriment of the estate. Helpful suggestions by the attorney include:

(a) The role of life insurance as a convenient means of avoiding needless sacrifice of valuable holdings for which there may be no purchaser available on death.

(b) Use of the stock liquidation trust.

(c) Public sale of a portion of the holdings.

(d) Establishing a record with respect to value. One method is to make certain gifts at which time the subject of value is considered by the Treasury Department. In many cases, since the amount involved is much smaller than would be the evaluation on death (when the worth of the entire holding comes into question) there is a possibility of establishing a relatively more favorable value. It is recognized that owing to the time

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element and changes in economic conditions, value at date of death may differ radically from that obtaining at the time of the gift. But in any event, this first step will have established some index as to the Treasury Department's thinking in the particular case. Some of the problems in this regard are detailed below under the caption, "Valuation of Closed Corporations."

4. *Attainment of Objectives for Family.*—Equally important to the client is the knowledge that his long term objectives relative to the financial safety of his wife and children can be obtained via the use of a trust. The actual effectuation of these objectives can best be carried out by qualified institutions and individuals experienced in the complexities of trust investment administration. It is a well established fact that the average widow who receives a large sum of money, subject only to her own supervision, usually dissipates the fund in a remarkably short period. This occurs either as a result of her own inexperienced judgment or unsound counsel, from those who have an axe to grind, or the importunings of less fortunate relatives who invariably seem to need a "few extra dollars."

III. TRUST INVESTMENT ADMINISTRATION

Three major steps are involved in connection with an individual's estate problem.

(a) Proper formulation of the estate plan in light of objectives;

(b) Setting up proper legal vehicles to put the plan into effect; and

(c) Aside from tax and other legal problems, proper administration. In this last category, investment administration is one of the most important.

It must be recognized that one cannot merely buy and hold a security. Constant attention must be given to changes in the general economic scene; to changes within an industry; to the trend of a particular company. Changes in management, or technology, or in supply-demand conditions, or in price, may require investment action. Problems of detail relative to handling securities include the following: call of bonds, making presentation thereof; exercising or selling "rights"; conversion privileges; tenders to sinking funds; etc. It is surprising how many people

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hold bonds for months after they have been called, or present issues for retirement at call price when a higher value could be realized by exercise of a conversion privilege.

Of fundamental importance is the determination of the proper investment plan, that is establishing the proper framework to give balance to the portfolio and to accomplish the objectives of the settlor or donor. No plan, no matter how well conceived, can be considered successful unless the actual execution of it is favorable, as measured by actual performance over a period of time.

The first step is to determine policy. Trust investment is concerned with conservation of principal and the attainment of maximum regular income. Obviously, administration of a fund along these lines is radically different from that applicable to a "business risk" fund, where greater risks can be assumed. A keystone of general policy is to recognize that different types of securities perform different functions. Those that provide utmost safety, as for example U. S. Government bonds, do not afford a liberal income, nor do they provide growth prospects. On the other hand, it may be deemed advisable to "hedge against inflation," as beneficiaries are interested in real purchasing power. Common stocks of extractive industries, which in many cases meet this requirement, do not provide price stability and are subject to many risks.

The problem best can be illustrated by the naive woman who asked for advise as to what issues to buy, saying she wanted "100% safety, little or no risk of intermediate price fluctuation, an issue that provides liquidity, affords a good rate of return, and has satisfactory appreciation prospects." Unfortunately there is no such investment. Until the day we find "convertible, participating, U. S. Government Bonds" there will be no such investment.

What then can be done? Those entrusted with trust investment responsibilities must recognize that the best program is that which has the proper checks and balances to meet the greatest number of contingencies so that the fund, on balance, will see principal kept intact and at the same time attainment of a reasonable rate of return on investment. At the outset the funds should be classified into three major categories, as sum-

marized below. The percentage relationships are approximate, and are subject to variation, depending on the personal situation of the individual, general market conditions, etc.

	Percentage of Total	Average Estimated Yield
PRIMARY RESERVE (Complete safety of principal) U. S. Government bonds, prime municipals and corporate bonds	35-40%	2.75%
SECONDARY RESERVE (Basic safety of principal, but greater price fluctuation; for stable income; enjoys greater rate of return than "primary reserve" items). Includes selected preferred stocks and medium grade bonds. Involves lesser price risks than equities..	25-30%	4½%-5%
INVESTMENT ACCOUNT. Good quality, income producing stocks; demonstrated earnings and dividend record	30-35%	4½%

A period such as the present involves unusual difficulties. Unlike the 1920s, prime long term bonds today provide a low yield, approximately 2¾%. They carry distinct risks of inter-



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mediate price fluctuation. High grade preferred issues yield only $3\frac{1}{2}\%$ to $3\frac{3}{4}\%$, and like good bonds are subject to the "money market" risk; and thus would sell off as interest rates firmed. Such preferreds do not even provide the protection of a fixed maturity date. Common stocks, likewise, involve problems pertaining to safety of principal. There is no sure solution. The best procedure is to diversify on a reasonable basis and to select issues providing sound intrinsic values, and to exercise diligent supervision over the portfolio.

There are other specific things which can be done by those adequately versed in the field of trust investments. One involves the use, in moderate degree, of so-called "special situation" bonds and preferred stocks which provide an abnormally high rate of return—in some cases more than 5%. This type of situation must be well protected asset-wise and earnings-wise. The issues should have enjoyed continuity of interest or dividend payments; and there should be a substantial market equity in the common stock which is junior to the issue under consideration. Also, the use of "cushion" bonds or preferreds is warranted. This refers to issues where the price is restricted by a relatively low call feature, and thus such issues are selling at lower prices than otherwise would be the case, quality considered. Since present market conditions are not propitious to new financing, many of these issues are not likely to be called. Of course, they should not be purchased without thorough investigation as to likelihood of call as well as to the details of the call provisions.

An important aspect of investment administration is the tax implications in any given situation. For individuals or trusts in high tax brackets, there are important advantages in purchasing suitable quality municipal bonds on a yield-to-maturity basis. A recent analysis of a \$100,000 program so invested at an average tax-free yield of only 1.36% in twelve year municipals, indicated that at the end of that period, the particular individual would have realized approximately \$16,320 net income after taxes, compared with only \$3,640 obtainable from U. S. War Bonds, Series F.

Another important aspect of competent investment management concerns utilization of capital gains and losses. In essence, this involves establishment of short term losses and of long



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term gains. Each dollar of short term loss will offset two dollars of long term gain. This makes it highly important for individuals, just before the expiration of the six month holding period, to establish tax losses—with reinvestment of the proceeds in comparable or other securities. Also, it is beneficial for individuals to establish long term gains just after the six month holding period. The same security immediately can be repurchased. The investor pays a comparatively small commission to insure against possible price decline in the course of the next six months. By following this procedure, one doubles his tax cushion against possible intermediate price decline.

In drafting trusts, attorneys advantageously can implement legal principles by utilizing provisions based upon actual administrative experience. California, like the majority of states, follows the Massachusetts or "prudent investment" rule. Under this, if there is no restrictive provision in the trust instrument, the trustees are authorized to invest in such issues as a "reasonable and prudent" man would utilize. This is a definite improvement over the New York rule, under which trust investments were restricted to "legals," usually fixed income obligations. Where trust investments have been restricted to bonds, the life tenants have suffered as a result. They have been hurt by the double impact of the sharp drop in the rate of return and by the increased cost of living.

The evolution toward the more liberal rule reflects the fact that no settlor can foresee conditions in the indefinite future, and thus he cannot visualize the potential adverse effects that restricted types of investments can have on the beneficiaries. Trusts should include some restrictive provisions to protect principal, although at the same time reasonably broad powers should be granted to the trustees. It should be recognized that there is no perfect solution to the problem of trust investment other than the experience, ability, and integrity of those entrusted with the investment powers.

To maintain flexibility and at the same time provide a hedge against risks inherent in common stocks in which trusts are forced today to obtain income, the trust instrument can include provisions leading the trustees to sell common stocks as prices rise (thus "freezing" a portion of the profits on the way up)

and permit additions of common stocks as the market moves lower. This will make possible maintenance of the desired percentage relationship, based on market values, between equities and other assets of the trust. This is a reasonable procedure, because as common stock prices rise, the yields tend to become smaller and the price risks tend to increase. The converse applies as equities reach relatively lower levels.

To illustrate, assume that the settlor provided that 35% of the fund can be invested in common stocks, and that the trustees must review and appraise the portfolio not less than semi-annually. Assume that this arrangement came into being when common stock prices were relatively low. At the end of six months, if the level of stock prices has moved higher, the trustees would be forced to sell out a certain percentage of equities and reinvest the proceeds in bonds or preferred stocks. If the bull market continued another six months, they again would be forced to "chip off" on the equities. If, however, the market declined during the six month period, a valuation might show that the common stocks dropped to 25% of the total portfolio. The trustees then would be empowered, but not obligated, to dispose of senior issues and to buy equities at the lower level. The system provides an avenue for conservative representation in common stocks and at the same time reduces the possibility of loss of principal.

IV. VALUATION OF CLOSED CORPORATIONS

The question of valuation of any enterprise which is closely held and where there is no quoted market for its outstanding issues is both difficult and important. The problem confronts the lawyer frequently, arising when a client is interested in the purchase or sale of a business; in connection with gift and estate taxes; and in relation to public flotation of a part or all of a major holder's stock. It is important to understand the various elements, the composite result of which constitute "value"; and in specific cases it is extremely difficult to determine value, because of the problems in coordinating and weighting the many elements involved.

Legal Principles: Various cases have held that value is considered a question of fact. Also, it has been held that the burden of proof usually is on the taxpayer and that he is not excused by the difficulty or even impossibility of establishing

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value as of the particular date (*Burnet v. Houston*, 283 U. S. 223, 227-8 (1931)).

What is meant by value? The income tax statutes refer to "fair market value" (*I. R. C.* Secs. 111 (b), 112 (c) and (d); 113 (a) (2) (4) (5)). Earlier statutes (Rev. Act 1918, Secs. 202 (a)(1), 326 (a)(2)) used the terms "fair market price or value" and "actual cash value." The estate and gift tax statutes merely say "value" (*I. R. C.* Secs. 811 and 1005). Section 1005 states, "If the gift is made in property, the *value* thereof at the date of the gift shall be considered the amount of the gift." However, the Treasury Regulations that apply indicate that value means "fair market value." (Reg. 105, Sec. 81.10; Reg. 108, Sec. 86.19.)

There are various definitions of "fair market value." The term can be defined as the market price which the given issue would command in the open market. It is the point at which there would be a meeting of the minds between a prospective seller and a prospective buyer dealing at arm's length, each having reasonable knowledge of the facts. It is advisable to keep a few general points in mind before considering the elements which determine "fair market value."

1. In approaching the subject of value, the courts have tended to be practical rather than academic. Various decisions in effect have held that the worth of a property for purposes of income and sale likewise is its worth for purposes of taxation. This renders particularly important a thorough and practical investment analysis of the issue.

2. Value cannot be determined with mathematical precision. As is brought out below, value involves forecasts and estimates of the future and thus the question of properly capitalizing an estimated earning power. If this appears theoretical, note that the stock market, in performing its so-called discounting function, constantly endeavors to do this. Therefore, the consulting economist in the field endeavors to find a *fair zone* of value as of the given date.

3. The Treasury Department in general appears reasonably objective in its approach. Keep in mind, however, that the *relative emphasis* given different factors in any one case can influence the ultimate findings as to value. The Department, like those representing the taxpayer, may stress book value in one

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case, earning power in another, general conditions in still another. It is the job of a well reasoned supporting brief on the taxpayer's behalf to emphasize the applicability and relative importance of certain factors in the case at hand.

Criteria of Value (Factors involved in determining market price):

There are various broad sets of influences which combine to determine fair market value.

1. *General Market Factors:* The value of any given enterprise is affected at any particular time by the broad economic and other factors which influence market evaluation of corporate worth. In other words, if the stock in question actually was listed and enjoyed a broad market, it would have sold at radically different values in 1929 and 1932, even if the statistical background was identical. The present year provides a perfect example. A new issue might have been successfully brought out in May or June at \$20 a share. This same issue offered any time in September or October likely would be priced around \$13 or \$14 per share.

2. *Intrinsic Value Factors:* This category includes: (a) Long term earnings history, (b) current earnings, (c) dividend record, (d) balance sheet position, and (e) fair rate of capitalization of earnings based upon statistical or quantitative factors, and also upon qualitative factors, such as nature of the industry, company's position in the industry, management factors, etc.

3. *Future Value Factors:* (Discounting of anticipated earnings which affects the capitalization ratio in relation to present earnings.) This includes such considerations as whether the company is a growth company in a growth industry (as, for example, the chemicals which have a high capitalization ratio), or whether the company and industry do not show prospects of future expansion; or whether it is a cyclical company and industry which may enjoy favorable near-term but dubious long term prospects. All factors are important if they provide an indication as to the direction and level of future earnings, with particular reference to the level of earnings to be anticipated. Similarly, consideration is given to the trends of gross revenues, profit margins and rate of return on investment.

Discussion of the specific applications of these general principles cannot be fully covered here. However, in any given case, the particular analysis and interpretations may well be crucial. Briefly, one method used is that of comparative values where there are similar issues that are publicly held. The sample used for comparative purposes must be sufficiently broad to permit of valid generalization, as a basis for its application to the situation under consideration. Also, certain analytical techniques have proven helpful. For example, assume the attorney and analyst desire to establish a relatively low value in a situation where a heavily capitalized company in a hazardous industry is enjoying peak earnings. The proponent of high value usually seeks to capitalize per share earnings. To rebut this, analysis of "margin of safety" is helpful. Simply expressed, it shows what a huge decline in per share earnings would occur even with a moderate decrease in gross if costs (and many costs are fixed costs) remained constant. Specifically, the writer had occasion to value a war inflated situation where per share earnings for the past two years averaged \$3.44. Yet under the above assumption, a 5% or 10% decline in gross would reduce per share earnings to \$1.25 and a loss of 55¢ respectively. Authoritative investment sources on this subject include, *Security Analysis* (1934) by Graham and Dodd, and *Investment Principles and Practice*, by Badger and Guthman.

Other phases of the subject which are relevant in specific situations include:

1. *Where an issue is quoted publicly, the courts usually find such the best evidence of fair market value.* However, if the issue is not listed and trades infrequently in small units, and there is a wide spread between the bid and asked prices, other evidence of value is readily admissible.

2. *In the case of a going concern, capitalization of earnings is given more weight than book value.* This generalization can be buttressed by citation of numerous authorities in the investment field. It finds its basis in actual investment experience. The actual record of thousands of publicly held enterprises discloses no correlation between book values and market prices commanded in the open market. In many cases book value is largely weighted by historical cost of plant and equipment,

which often has little relation either to realizable values or to earning power of the particular company. See *Estate of Pamela D. Holland*, 47 B. T. A. 807, 814 (1942), which holds that unless liquidation is contemplated, earning capacity is more important than book value in determining market value.

3. *Liquidity*: All other factors being equal, an issue which enjoys liquidity is entitled to sell higher than a similar issue which has limited marketability. After all, the ability to get out of a given situation immediately, where analysis indicates development of unfavorable conditions, has definite value to the investor. This means that the nonliquid situation is entitled to a lower capitalization of current and prospective earnings.

4. *Size of Block*: The question of how much the estimated value should be discounted to reflect the estimated effects on its price by offering a large block of stock is controversial. There is some valid basis in fact for arguing that this would depress the price. In times when the general market is strong, the effects are not too noticeable. Under unsettled conditions, such as have existed in recent months, even prime issues have been depressed piecewise by such offerings.

Conclusion: The success in handling valuation matters usually is proportionate to thoroughness of the preparation. An adequate job can be done only by the combined efforts of counsel handling the legal phases and the valuation analyst via his testimony as an expert and collaboration in preparing certain phases of the brief. It should be kept in mind that the courts do recognize a valuation analysis presented from an investment viewpoint. Since value is a matter of fact rather than law, appellate courts are reluctant to review the trial court's determination of value.

V. PUBLIC FINANCING

One of the most important phases of public financing deals with the question of value, which subject has been considered above. Normally where a "family corporation" has grown to a point where personal considerations render it advisable to market a portion of the company's stock, the controlling shareholders have little idea of value. As a practical matter, they either radically underestimate the present market value, or place such a high estimate that a marketing job is not feasible.

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The investment banker (underwriter) performs the important distributive functions *at a price*. They have the "feel of the market" and judge what the issue might command in the open market. At the same time, the management of the company knows his own operations, problems, and possibilities better than anyone else. The company derives financial and other advantages from utilizing expert assistance to prepare a valuation on its behalf. The investment banker must act as liaison for both the seller and buyer. Valuation studies prepared for the company are helpful both to management and the prospective underwriter.

Other related considerations involve pricing of the new issue (to decide in what general price *range* the issue can most advantageously be sold); the type of financing, whether bonds, preferred stock, or common stock; whether a senior issue should have a conversion privilege; and numerous other important problems. This will vary with the type of business and the particular requirements of the company. How many shares should be marketed? Should the issues be sold locally or on a

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national basis? What underwriters are best qualified for the particular type of financing? What is the best "timing" for the issue? All these related subjects should be thoroughly explored so that the seller need not in effect say to the underwriter, as so many companies do, "We want to sell some securities. We need some money for the company. We don't know what the company is worth. We don't know how many shares of stock or how much bonds to sell. We don't know where the issue should be priced nor when it might be brought out. Please tell us what to do."

CONCLUSION

The foregoing discussion summarizes some of the legal-financial fields where the attorney, in collaboration with the financial analyst, can perform valuable services for his clients, and thus, by the application of sound business development methods benefit himself. The practical advantages of a soundly conceived plan as formulated by the lawyer and administered by qualified investment counsel merit the consideration of members of the bar alert to the possibilities of supplementing corporate work by personal estate and tax matters; and, conversely, of proceeding from legal work for individuals to matters involving the estates of the controlling stockholders.

LETTERS TO THE EDITOR

Editor's Note: Hereafter the Bulletin will print letters which may be of interest to members of the Bar either by way of reply to or criticism of, articles heretofore published in the Bulletin, or which may contain new suggestions or ideas worthy of consideration.

EDITOR, LOS ANGELES BAR BULLETIN,

DEAR SIR:

In the October BAR BULLETIN, Mr. Ewell D. Moore editorializes that if the atomic bomb is "not forever banished as a weapon," then "within the lives of persons in being," there will be left "only a few dazed, slack-jawed human survivors wandering aimlessly in scattered groups, like slinking, starving animals with only the instinct left to scavenge for food."

Mr. Moore dismisses international atom control with these words: "But is there anybody so gullible or impractical as to believe that all nations will agree to adopt any kind of reasonable plan? Or, if they might by the remotest chance adopt one, that they will keep its covenants? History and human nature furnish no example from which we may draw the slightest hope of continuing world peace; or that in event of war the bomb will not be used."

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If that be true, then how can anybody be "so gullible or impractical as to believe" that the same human nature would permit the same nations to keep an agreement outlawing the atomic bomb?

Mr. Moore has thrown up the sponge of human hope and resigned himself to the dire calamity he predicts.

I am not so pessimistic but prefer to trust the human nature of the American people.

* * * * *

As long as we know more about the atomic bomb than anyone else, I think we will be safe. As soon as we lose that advantage, then I fear the worst. Attila, Hitler and Mussolini knew no conscience. They are gone, but others like them may arise. In view of "history and human nature" I believe that world peace and security depend upon the retention by this nation of supremacy in atomic knowledge.

Let us retain that supremacy.

Very truly yours,

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acquainted with a lawyer, the program is closed with a word concerning the availability of the Lawyers Reference Service maintained by the Association.

The scripts are written by members of the Radio Committee of the Association, Harold W. Schweitzer, Chairman, with the assistance of a professional script writer. Paul Forrest, Promotion Manager of KGFJ, reports that the public is showing an increasing interest in the program.

STATEMENT OF THE OWNERSHIP, MANAGEMENT, CIRCULATION, ETC., REQUIRED BY THE ACTS OF CONGRESS OF AUGUST 24, 1912, AND MARCH 3, 1933

of LOS ANGELES BAR BULLETIN, published monthly at Los Angeles, California, for October 1, 1946.

State of California, County of Los Angeles.—ss.

Before me, a Notary Public in and for the state and county aforesaid, personally appeared Robert M. Parker, who, having been duly sworn according to law, deposes and says that he is the business manager of the Los Angeles Bar Bulletin, and that the following is, to the best of his knowledge and belief, a true statement of the ownership, management (and if a daily paper, the circulation), etc., of the aforesaid publication for the date shown in the above caption, required by the Act of August 24, 1912, as amended by the Act of March 3, 1933, embodied in section 537, Postal Laws and Regulations, printed on the reverse of this form, to wit:

1. That the names and addresses of the publisher, editor, managing editor, and business managers are:

Publisher—Los Angeles Bar Association, 1124 Rowan Bldg., Los Angeles 13, Calif.

Editor—Frank S. Balthis, Jr., 640 Rowan Bldg., Los Angeles 13, California.

Managing Editor—None.

Business Manager—Robert M. Parker, 241 E. 4th St., Los Angeles 13, California.

2. That the owner is: (If owned by a corporation, its name and address must be stated and also immediately thereunder the names and addresses of stockholders owning or holding one per cent or more of total amount of stock. If not owned by a corporation, the names and addresses of the individual owners must be given. If owned by a firm, company, or other unincorporated concern, its name and address, as well as those of each individual member, must be given.) Alex W. Davis, President, 514 Pacific Mutual Bldg., Los Angeles 14, California. Walter L. Nossaman, Secretary, 631 Title Insurance Bldg., Los Angeles 13, California. Ewell D. Moore, Treasurer, 620 Subway Terminal Bldg., Los Angeles 13, California. Los Angeles Bar Association, 1124 Rowan Bldg., Los Angeles 13, California.

3. That the known bondholders, mortgagees, and other security holders owning or holding 1 per cent or more of total amount of bonds, mortgages, or other securities are: (If there are none, so state.) None.

4. That the two paragraphs next above, giving the names of the owners, stockholders, and security holders, if any, contain not only the list of stockholders and security holders as they appear upon the books of the company but also, in cases where the stockholder or security holder appears upon the books of the company as trustee or in any other fiduciary relation, the name of the person or corporation for whom such trustee is acting is given; also that the said two paragraphs contain statements embracing affiant's full knowledge and belief as to the circumstances and conditions under which stockholders and security holders who do not appear upon the books of the company as trustees, hold stock and securities in a capacity other than that of a bona fide owner; and this affiant has no reason to believe that any other person, association, or corporation has any interest direct or indirect in the said stock, bonds, or other securities than as so stated by him.

5. That the average number of copies of each issue of this publication sold or distributed, through the mails or otherwise, to paid subscribers during the twelve months preceeding the date shown above is..... (This information is required from daily publications only.)

ROBERT M. PARKER,
Business Manager.

Sworn to and subscribed before me this 1st day of October, 1946.

[Seal]

MARGUERITE F. CRIFFS,
Notary Public in and for the County of
Los Angeles, State of California.

My commission expires January 3, 1948.

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